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NOMINATION OF NICHOLAS F. BRADY

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON THE

NOMINATION OF

NICHOLAS F. BRADY TO BE SECRETARY OF THE TREASURY

SEPTEMBER 13, 1988

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NOMINATION OF NICHOLAS F. BRADY

TUESDAY, SEPTEMBER 13, 1988

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing of the Committee on Finance was convened, pursuant to notice, at 2:41 p.m., in Room 5D-214, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (Chairman) presiding.

Present: Senators Bentsen, Moynihan, Baucus, Bradley, Pryor, Rockefeller, Daschle, Heinz, Wallop, Durenberger.

Also present: Senator Frank Lautenberg, Nicholas F. Brady, Secretary of Treasury Designate.

[The press release announcing the hearing follows:]

[Press Release No. H-35, September 2, 1988]

FINANCE COMMITTEE TO HOLD HEARING ON THE NOMINATION OF NICHOLAS BRADY TO BE SECRETARY OF THE TREASURY

WASHINGTON, DC.—Senator Lloyd Bentsen, (D., Texas) Chairman, announced Friday that the Finance Committee will hold a hearing to review the nomination of Nicholas F. Brady, of New Jersey, to be Secretary of the Treasury.

The hearing is scheduled for Tuesday, September 13, 1988, at 2:30 p.m. in Room SD-215 of the Dirksen Senate Office Building.

Mr. Brady is currently Co-Chairman and a Managing Director of Dillon, Read & Co., Inc., a New York investment banking firm. He also served as a member of the United States Senate from New Jersey from April 20, 1982 through December 27, 1982.

OPENING STATEMENT OF HON. LLOYD BENTSEN A U.S. SENATOR FROM TEXAS

The CHAIRMAN. This hearing will come to order. The Committee on Finance is meeting today to hear Nicholas F. Brady, President Reagan's nominee to be Secretary of the Treasury.

Nick Brady is a friend and a former colleague and in my opinion is a man who is well qualified to be Secretary of the Treasury. If confirmed by the Senate, Mr. Brady will assume a responsibility for a wide range of programs and problems of vital importance to America's economic future.

The Secretary of the Treasury plays a prominent role in domestic and international finance, in tax policy, in stabilizing the international monetary system, and in resolving some of the trade problems. In this Administration, the Secretary of the Treasury has become a very major player when it comes to trade policy.

So, it is a big job, a tough job. But, Mr. Brady, you are used to tough jobs.

I thought the Brady Commission Report on the October market crash was an excellent study that should have been required reading at the White House. There are serious issues out there and they deserve some high level attention regardless of which party is in the White House next year and one of those problems is trade. As I am sure you are aware, Congress has had a very difficult time getting the Administration's attention on trade policy. We watched the trade deficit increase from $39 billion to $194 billion over the past eight years. Half a trillion dollars in accumulated deficits were financed by borrowing abroad.

We have given other nations a mortgage on America's economic future. We saw more than 650,000 skilled jobs, high-paying jobs, disappear from manufacturing in this country and go overseas, and we saw America's technological leadership disappearing in several areas.

So this Committee had to move out and fill that vacuum on trade policy and we crafted a strong, bipartisan trade bill based on the simple premise of fairness, that any country that had full access to our markets had a responsibility to give us full access to its markets. That was the thrust of that piece of legislation.

Unfortunately, the Administration put a lot of road blocks in our way and we finally had to beat a veto. We had to drag the President to the altar, but finally, he signed on to a trade policy that I think makes sense for America.

So I hope that with the beginning of your tenure at the Treasury, we can start to work together to find honest answers to the real problems facing the American economy. Americans can differ about the true performance of our economy in recent years, but on some points there can be no dispute.

No one can dispute that we have almost tripled the national debt in eight years. We will pay $160 billion worth of interest on that debt next year.

No one can dispute that interest rates are rising or that the rule of economic growth this decade has been one of the slowest since the Great Depression.

No one can dispute that real weekly pay checks have declined since 1982, and that capacity investment is the slowest since the 30's. Savings have hit record lows. Our productivity growth is the weakest on record. And our problems with trade are far from over.

No one can dispute that in the short period of three years America stopped being the number one lender nation in the world and became the number one debtor nation in the world.

I know we have said to countries like Mexico and Brazil, "Move aside, you are pikers." We are now the number one debtor nation in the world.

You understand finance and you appreciate reality. And you know, as we know up here, that you do not buy real growth and prosperity on a credit card. You also know what happens when nations run up huge international debts and then have trouble paying them back and what we have done in the past.

We have sent down the American Ambassador, our Secretary of the Treasury, the IMF, whatever it takes, to tell those nations to put their house in order. And then we tell them how fast they can grow and how much they can import. You name it.

No one wants or expects to see that happen to America. That would be the ultimate irony. So I hope that we can all work together to set aside the differences and get the job done. I hope we can restore the spirit that we saw after the stock market crash when Republicans and Democrats, and the Congress and the Administration, worked out a deficit reduction package and we wrote it into law.

Mr. Brady, I do not know what is going to happen after November 8th. I will either be in the Vice-President's office or I will be here at the Finance Committee. And you will either be at Treasury or someplace else making a contribution to the free enterprise system.

But no matter how it works out, and I admit I have some strong prejudice on that question, but I look forward to working with you to build an economy with prosperity and opportunity for all Americans.

And I would like to defer now to my colleagues for any comment that they might have.

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY

Senator BRADLEY. Thank you very much, Mr. Chairman. It is a real pleasure for me to have the opportunity to formally introduce to the Committee Nick Brady.

We all know him. He was a colleague of many of us for two years, when we served together in representing New Jersey. I came over that time to consider him a friend. I still do.

I think that he is competent. I think that he has impeccable integrity. I think that he has a real sense of public service. And he brings valuable experience in handling the issues which involve the economic dimensions of national security. He will bring that to the Treasury.

This is particularly important now as national security and international economic issues intermingle in areas such as the Third World, and in issues such as the exchange rate, volatility, and the Third World debt.

He brings experience to bear on banking and financial issues that is particularly important as our financial markets adjust to rapidly changing global conditions. He has an ability to discriminate between the legitimate and the specious claims banks will make on public policy.

Mr. Chairman, I think that he will serve well. I hope that the Committee will confirm him, and that the Senate will confirm him. And I would finally say that I do not think having graduated from Yale necessarily should disqualify anyone for public service. (Laughter)

The CHAIRMAN. I think he could overcome that. Senator Lautenberg.

OPENING STATEMENT OF HON. FRANK R. LAUTENBERG, A U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. Mr. Chairman and Members of the Committee, I am pleased to have the opportunity to appear before you

today with Nick Brady. It is an honor to be able to introduce him and to strongly recommend his confirmation as the next Secretary of the Treasury.

Before coming to the Senate, I was in the corporate world in New Jersey where Nick Brady's reputation for excellence and leadership was widely known. He is known throughout the State of New Jersey for integrity, for competence, and commitment to public service. The President has made, in my view, an excellent choice.

Nick Brady has a distinguished record of contributions to New Jersey and the country. Nationally, he may be best known as the head of the Commission that investigated last October's stock market crash.

But the people of our State also remember his service in this body where he served ably in 1982 as one of New Jersey's Senators.

Nick Brady has what it takes to be an excellent Secretary of the Treasury. He knows Washington and he knows the financial world. And perhaps equally important is, Washington knows him and the financial world knows him, also.

Through his work on the Brady Commission and in the Senate, Washington knows Nick Brady as a straight shooter. He is a man who says what he thinks and who means what he says.

The people of Wall Street know him through years of experience. He is a man who understands their language and commands their respect. Clearly, he is a man who understands the realities of the financial marketplace and the economy.

The next Secretary of Treasury will come into office with plenty to do and very little time to do it. He will have to work with Congress on several matters—banking legislation, the free trade agreement with Canada.

He will also have to deal in the international area with our trading partners and with international institutions like the World Bank. It will not be easy, but we have confidence that someone of Nick Brady's competence will have the ability to do just that. He has the talent and the experience to do the job.

I am convinced that given the opportunity he is going to do it very well.

I want to thank you, again, Mr. Chairman and Members of the Committee for the opportunity to speak today on behalf of Nicholas Brady and I hope that you will give his nomination prompt and favorable consideration.

The CHAIRMAN. Mr. Brady, it looks like you are on a roll without having said a word.

I would like to ask Mrs. Brady to stand, the very attractive Kitty Brady. We are delighted to have you. Thank you.

If there are no further comments—We want some from you, Mr. Brady. Do you have a prepared statement or not?

OPENING STATEMENT OF NICHOLAS F. BRADY, SECRETARY OF THE TREASURY DESIGNATE

Mr. BRADY. I do, Mr. Chairman, a short one.

I would like to thank my fellow New Jerseyians, Bill Bradley and Frank Lautenberg, for their very kind words. And, Chairman

Bentsen, I would like to thank you for taking the time out of what everybody knows is a very busy schedule to chair these hearings.

It is a great honor for me to appear before you today as the President's nominee to become Secretary of the Treasury.

I come before you today as a nominee for my second government position in less than six years. My tenure as a member of the Senate, although short in duration, was long in quality and learning. Perhaps the single most important lesson of that time was that members of the government, from both the Executive and the legislative Branches, worked most effective in the national interest, and they worked together in a bipartisan way. If confirmed, that lesson will be a guiding principle.

I have had the distinct pleasure of working with many of you when I was in the Senate, others when I served on various Commissions, and most recently when I chaired the Presidential Task Force on Market Mechanisms. In each case, I have found that understanding and solid results were obtainable when all views and ideologies were observed and taken into account. This, too, will be a guiding principle.

The founder of the firm for which I have worked for over 30 years maintained that when faced with a difficult problem, one should assume that ""the devil lies in the details," and that there is no substitute for doing the pick and shovel work. I also believe firmly in that guiding principle.

Although there are only a few months left in President Reagan's Administration, there are important matters before us which demand our attention.

We have a strong economy now, viable, enjoying its 70th month of expansion. As our exports rise and our trade deficit declines, we must continue a sound monetary policy and a responsible fiscal policy to keep the economy moving in the proper direction.

Largely through the efforts of my predecessor, Jim Baker, we have developed strong and meaningful relationships with the G-7 countries, under which we have been able to coordinate international economic policies, not only to our benefit but to the benefit of the rest of the world as well.

In this regard, my first task, if confirmed, will be to attend a G-7 meeting in Berlin late next week and to represent the United States at the IMF World Bank meetings. I will assure both gatherings of our Government's intention to continue the strategy of economic cooperation.

Also, we have a Bipartisan Budget Agreement worked out nine months ago between leaders of the Congress and the Executive Branch which will ensure appropriate deficit reduction without dislocation during this fiscal year and next. Adherence to this agreement is vitally important to economic stability, and I will do everything in my power to guarantee its integrity.

To be sure, there are problems at home such as those facing the thrift and banking industries and abroad such as the treatment of Third World debt. All require surveillance and attention. None is insurmountable.

I would be pleased to answer any questions the Committee may have. If confirmed, I look forward to working with Members of the

Senate Finance Committee, the Senate and all of the Congress to address and resolve the matters before us.

Mr. Chairman, thank you.

The CHAIRMAN. Mr. Brady, you were talking about heading up the U.S. delegation to the meeting of G-7 Finance Ministers in Berlin on September 24th.

Now given the close linkage of exchange rates and macroeconomic policies to our trading balance, and the substantial trade deficit that we have been experiencing—and it is flattening out, at least for the present, not seeing the additional improvement we would have hoped for—do you anticipate taking the Trade Ambassador, Clayton Yeutter, with you?

Mr. BRADY. I believe he has been invited, sir. I am not sure. I have not seen the list of invitees yet.

The CHAIRMAN. Let me tell you the reason I asked you that. So often I have seen us have economic summit meetings and the Trade Ambassador is not a part of that. And yet I watch other executives from other countries—chief executives, in particular—and they have their Trade Ministers with them.

And it is just a deep, strong conviction of mine that trade has not received the kind of priority that it should have in this country of ours. Trade has been used as handmaiden for other foreign policy objectives of the moment.

And being new to the particular office, in spite of your great wealth of background experience, I would urge you to give serious consideration to having someone who is currently conversant with all of the problems that we are having in our trade negotiations along with you.

Another question I have relates to the recently enacted omnibus trade bill. We required the Secretary of the Treasury to initiate a study of the feasibility of establishing a multilateral body to handle Third World debt matters and to seek the negotiation with other countries of establishing that kind of an agency.

Have you had a chance to look at that provision? If you have not, I would urge that you do that and give that consideration.

Mr. BRADY. Senator Bentsen, I have not had a chance to look at it, but I will.

The CHAIRMAN. Another concern that we have in this Committee is with the problem of drug interdiction. One of the places to stop drugs is right at the border.

We had a General Accounting Office study that showed if there were some slight transfer of the resources used, not asking for more money, but a transfer of some resources to the border that we would have a material increase in the efficiency of stopping drugs from coming across.

Yet this Administration, time and time again, has tried to cut the Customs Service budget and cut the number of Customs personal. I have fought those cuts, as have the majority of this Committee. The border is a critical point of interdiction.

And it is not a budgetary problem because the Congressional Budget Office has stated that you get back $17 for every dollar expended on the Customs budget. And even on the incremental edge, you get back $3 for $1 spent through the collection of additional duties.

Do you have any comment on that insofar as your feeling about the number of Customs officials?

Mr. BRADY. Senator Bentsen, I really do not. I understand that the Customs Service protects the boarders but I am not familiar with the items that you have just cited.

The CHAIRMAN. All right.

Mr. BRADY. I want to assure you, however, that we will do our utmost to make sure that the kind of things that you talking about do not occur.

The CHAIRMAN. Mr. Brady, here you have a situation where Customs can not only be effective in stopping drugs from coming across, but you save the taxpayers money.

And that, to me, makes such basic fundamental sense that I would strongly urge you to be sympathetic to appropriate staffing and full staffing for Customs on the border.

Because of the limitation of time and good attendance here, we will limit the questioning to five minutes. And now that the Chairman is finished, please impose it. (Laughter)

I defer now to, on the early-bird list, Senator Moynihan.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Mr. Chairman, I would like just to pursue a line of inquiry based on concerns which I am sure Mr. Brady shares with this Committee about the extraordinary increase in the national debt in the last eight years.

The first Secretary of the Treasury who had to deal with this was Alexander Hamilton, who is well known to you, sir.

In spite of the Congress to assume the debt of the individual states and paid it all off in full and established the credit of the United States, in his first report to the Congress in that regard, he said, "Remember, this debt was the price we paid for liberty."

Probably all through our history, the real debts we have acquired have been associated with wars at one time, not this last trebling in eight years. It has just been an internal consumption.

And with that at least partially in mind in 1983, and in 12 days in January, your predecessor, then Chief of Staff, and Barber Conable, will be head of the IMF you will be meeting with—the World Bank, rather.

Senator Dole, the Chairman of the Finance Committee, myself and some others, we put together a Social Security package—the Social Security Amendments of 1983 which moved us from a year-by-year, pay-as-you-go basis Social Security to a partially funded system. Canada did that in 1966. Such that in the Trustees who have just reported in the Spring foresee a 75-year close actuarial balance. They see funds peaking at $11.8 trillion and that is true.

But the more important fact is that between this year, 1988, and the year 2018—in 30 years—the Treasury will receive $3 trillion, above and beyond the outgo of payments in the Social Security funds—$3 trillion in 30 years.

Could I ask, if we were to somehow balance our budget and use that $3 trillion to retire the privately-held debt, would we not have an extraordinary impact on interest rates; would that amount not

increase national savings? It automatically becomes an increase in savings. Would we not affect the markets? Would we not, in fact, get back into the saving mode that we have gotten out of as Mr. Bentsen said, in the course of our trouble.

I guess what I specifically want to say to you is, would you advise the next President, the present President, that whatever we do we must not use those Social Security surpluses for the ongoing costs of current government operations?

Mr. BRADY. Senator Moynihan, I would advise the next President not to use those funds. Of course, we have a unified budget, but I believe the study to which you refer—I have not seen the details of it—shows surpluses for a number of years followed by deficits.

And I think it would be very dangerous to take that into account—a statistical, theoretical study—and make any changes in the way we approach this problem.

Senator MOYNIHAN. Surely, sir, you would know that the study was the managing trustee. That was not a study. That was a report from the Secretary of the Treasury. He said in the next 30 years we will have a $3 trillion surplus in cash is into the trust fund. That is not a theory.

As long as we say it is a theory, it is something that we can ignore. It is a reality. It is a reality. And can we not get some assurance that you would want to save that money and not use it for the current expenses of government?

Mr. BRADY. It was a study, Senator Moynihan. My understanding of it was, that it was a projection for 75 years into the future. And for awhile it shows annual surpluses and after that it shows annual deficits.

So, I think my feeling is, and I would certainly have to take another look at that, based on those projections to make any changes in the way that we approach the Social Security system now which is something sacrosanct, would be a big mistake. I think that is what you are driving at.

Senator MOYNIHAN. I appreciate that. I would like to return to Mr. Chairman, but may I say, sir, it is not a study. It is the report of the trustees.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Moynihan. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Nick, probably the most significant accomplishment of your predecessor was the Plata Agreement that called for intervention in the exchange rate markets by various central banks.

In 1987, for example, the Japanese intervened to the tune of about 40 billion buying dollars. This year it is going to $60 billion.

In the absence of a continued willingness on the part of the Japanese and the Germans to intervene in the exchange markets, if we do not want the dollar to drop through the floor, the only alternative is for us to raise interest rates in this country to try to attract that capital.

Now my question to you is, do you think that it is likely that the Japanese and the Germans will be as forthcoming and do you think that they would continue to intervene in the amounts that they have; do you think that they would continue to purchase U.S.

Treasury debt, et cetera; and what thought have you given to that problem over the next four or five months, which is a very critical period in both the markets and in the political picture?

Mr. BRADY. Senator Bradley, as you know the intervention process is something that is carried out by the finance ministries and central banks. And to give too much of a statement as to what I think about that before I have attended a meeting, met the other finance ministers, and heard their feelings would be presumptuous on my part.

I see, as of today, no letup in the confidence that foreigners have in our debt. I will admit that there is a lot of it around, but foreigners still have confidence in this system and continue to buy our debt.

But I think if you would allow me to go to the World Bank meetings and meet with my colleagues in the finance arena, then maybe when I come back I could make a more complete report to you.

Senator BRADLEY. As to your assessment of their willingness to continue the agreement?

Mr. BRADY. Well, absolutely. I mean, I have not spoken to any of them yet and I would be glad to report to you when I get back. But I have no idea what they think.

Mr. Bradley. One other question, and it relates to the Inter-American Development Bank.

As you know, the United States has blocked Inter-American Development Bank operations during a dispute over U.S. veto powers. Now, in just the last several years, and actually the last two years, $40 billion in capital has flowed net from Latin America to the Developed World.

You would think in normal development, economics, the flow should be the opposite. The $40 billion has flowed to the Developed World. With a blocking of Inter-American Development Bank operations, it only makes the problem in Latin America worse.

Could we expect that when you are confirmed that you will attempt to resolve this issue so that we will be able to see the kind of capital flows that will restore growth in the Latin American countries and that, in turn, will increase our sale of exports to those countries and employ more Americans?

Mr. Brady. Senator Bradley, as you might guess, I am not familiar with that particular process, but I will look into it and come back to you.

Senator BRADLEY. Thank you very much.

The CHAIRMAN. Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you, Chairman.

Mr. Brady, as you well know, during the Administration which you will now serve, that is in the last eight years, our total national debt increased from, approximately, $1 trillion to today $2.3 to $2.4 trillion. It more than doubled in the last seven years.

Second, our annual trade deficits increased in 1981 to 1987 from about $31 billion a year up to a high of $178 billion, and now level-

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ing off at about $130 billion $31 billion from the beginning of this Administration.

As you also know, in a national debt, we have changed during the last seven to eight years from being the world's largest creditor nation to being the world's largest debtor nation. In fact, I think at the end of this year we will be $400 billion in interest payments alone on international debt.

You have a background, you are known as somebody that is very public spirited. You served on many Presidential Commissions. Your record is one of service to America.

What do you recommend to the President to turn around, what I regard and what I think you probably regard as, a very worrisome financial picture facing America?

Mr. BRADY. Well, Senator Baucus, I cannot quite characterize it that way. I do take the point that the amount of our national debt held by foreigners is a much larger number than it used to be. The world financial system is also much larger than it used to be.

And I think, if my statistics are correct, the percentage of our debt that is held by foreigners, both total debt and marketable debt, has declined a bit since 1978. So, although it is an enormous figure, it is relatively less than it used to be and in a sense reflects the rest of the world's confidence in our credit.

And as I said earlier, I do not see any change in that at this particular moment in time.

Senator BAUCUS. Is that to say that you recommend a continuation of this increase in international debtor status?

Mr. BRADY. No. No, it is not; but it is to say that it is by historic levels, as a percentage of the total debt outstanding, not larger than it has been over the last ten years.

Senator BAUCUS. Some economists who say that if this continues, this trend, that the dollar outflow overseas to foreigners, that is interest payments on the debt, will have in effect lowered U.S. narrative living to 2 to 3 percent, which is the exact amount by which the American standard of living lowered during the Depression.

Do you disagree with that?

Mr. BRADY. I do disagree with it.

Senator BAUCUS. Even with that magnitude of an outflow of dollars that would otherwise go in the American economy that go over seas?

Mr. BRADY. Senator Baucus, I do not agree that it is going to continue. I think that one of things that has happened in the last year with the lowering in the value of the dollar is that our trade deficit has turned around and will continue to turn around. And I think what we have to do is give the system a little time to work.

This industrial system that we have reacts quickly to changes and circumstances and a part of the overseas sales and business collecting system needs rebuilding. And that is going to get rebuilt.

My prediction is that the trade deficit is going to come down. And I think one of the surprises of the next two or three years is how fast it will come down.

Senator BAUCUS. Well, let me stay on that for just a moment.

Most, I think, analysts think the trade deficit is absent in unforeseen circumstances will probably level off about where it is, rough-

ly $100 billion a year. And to make matters a little more worrisome, some companies have said that they can break even at the yen-dollar ratio much different than today's. That is, the dollar-yen much lower.

For example, Bathushala says they can break even at 97 yen to a dollar. Tochi, 90 yen to a dollar. That is, they are competitive in America; they can be competitive in America with the yen that high, compared with the American dollar.

It just seems to me, if companies can break even in America at such dramatically different exchange rates at those levels, that the policy of trying to solve our trade deficit in the main, by a lower U.S. dollar, is not going to work. Second, it has the effect of lowering U.S. living standards anyway.

So I just strongly urge you and your advice to the Administration to not rely to such a degree on the low U.S. dollar because it does lower U.S. living standards. And second, I think it is too narrow. That Japan and other tries are going to find ways to be competitive in other ways.

I just frankly think that this Administration has been a little shortsighted, a little naive, a little narrow, in its long-range approach to trying to restore American financial growth, financial strength.

Thank you.

The CHAIRMAN. Thank you. Senator Durenberger.

OPENING STATEMENT OF HON. DAVE DURENBERGER, A U.S. SENATOR FROM MINNESOTA

Senator DURENBERGER. Mr. Chairman, thank you.

Nick, it is just great to have you and Kitty back. And the only former Senator I know that never gets called Senator, and I think that is a compliment to you and to your family, and to the great job you did while you were here.

My formal statement, Mr. Chairman, will include reference to a little story Nick told us all in his maiden speech, which I think if you have time to read it, would go a long way towards to sort of resolve the even in four or five months he will bring to bear on this job.

It is unfortunate that public hearings like elections focus on unresolved problems. It would be nice to run the credits across the screen today for what has been accomplished over the last eight years as well.

I will not try to do that during the course of this hearing, I think there will be a lot of that sort of discussion, but in other realms.

I have two, Nick. One suggested by Pat Moynihan's reference to Alexander Hamilton. I do not know whether, as he said, you have a great familiarity with Alexander Hamilton or not.

Senator MOYNIHAN. They said that you shot him.

Senator DURENBERGER. In New Jersey. (Laughter)

Senator MOYNIHAN. He died in Greenhaut.

Senator DURENBERGER. But not on his watch.

One of the things that Hamilton favored was the idea of opening the United States to foreign investment. And I noticed in my little informal poll, that some call the Great Minnesota State Fair, that

probably the one question that people ask me more than any other question was: With the low dollar and the attractiveness of the American market to foreign investors, is it possible that we need to place some restrictions on foreign investments in the United States?

What is your general view of the problem?

Mr. BRADY. Well, Senator Durenberger, it is not a new phrase, but I think it is one that is a good one. Which is, what we want is not free trade but fair trade. And I think that there are parallels in putting quotas and tariffs on. But at the same time, we have to be tough. And I mean tough about making sure that the foreign countries that export into this United States are giving our companies the same fair shake that we are giving the people who have access to our markets.

So I think we have to be a little careful. History is replete with examples of what happens when you get too heavy-handed with tariffs and quotas. And on the other hand, I do not think there is a thing wrong—in fact, I think it is a very good idea—to make sure that our companies, people who are trying to sell abroad, get the same fair treatment that we give people that sell in this country.

Senator DURENBERGER. I think the folks that asked me about it are more concerned about foreign investment in the United States—the "buying up" of a variety of attractive parts of America by foreign investors.

Does that concern you at all at this stage of our economic recovery?

Mr. BRADY. Sure. I think anybody has to be concerned on an individual basis when a foreign company comes in and takes over a U.S. corporation. Everybody's spirits are rattled some. But the very fact that this country is a place that the rest of the world wants to invest in is very good for this country. It stimulates jobs and it stimulates investment, and those things help.

So, as long as it remains at this level, I do not think that net foreign indebtedness of some 8 percent of GNP is disturbing.

Senator DURENBERGER. The second question. You made reference, I believe, in your opening remarks to the problems we are somewhat aware of in the savings, and the thrifts, and so forth.

Some of the estimates I have seen in terms of the costs associated with cleaning up the problems that S&L's and the Southwest Savings Banks and so forth, anywhere from $30 to $80 billion, do you think that ultimately we are going to have to see the taxpayers of this country bailing out the thrift industry in this country, and to what extent?

Mr. BRADY. Well, I am a little worried that there is a game going on that tries to make everybody come up with a higher figure for the amount of dollars that it is going to take to ultimately satisfy the obligations to the savings and loan industry. It seems to be kind of a thing to do, to top the last guy's estimate.

I think the most recent figure that I saw was by the GAO, and I think that was some $35 billion—big enough. I do not see any reason at this point in time for a taxpayer bail out. There are $19 billion of funds inside the FSLIC.

I think going at it on a one-by-one basis and trying to solve those things as they come up is the right way to do it. And I am told that

FSLIC cannot do anymore than they are doing right now anyway. So putting more money in the system would not help.

Senator DURENBERGER. Okay. Mr. Chairman, thank you.

The CHAIRMAN. Nick, they tell me I have other places to be today. I am delighted to have called this meeting early because I think it is awfully important that you move into that job, with its enormous responsibilities as quickly as you can.

I wish you great success and I will turn over the chairmanship to the Senator from New York, and call on Senator Rockefeller.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Brady, as you know from our previous conversation, I not only admire you greatly but support you completely in this confirmation process.

As Chairman Bentsen said at the beginning, the Secretary of the Treasury is involved very much in setting the tone and in some of the mechanics of the whole problem of trade.

I am one who has been worried for a long time that America, with its laissez faire attitude about trade, is waiting for the rest of the world to adjust to the way we do business. That, of course, is not the way it works. They just go right ahead and do things their way.

Lucky Goldstar, which is a big Korean conglomerate, has announced that it is going to build a multi-$100 million production and research facility with respect to semi-conductor fabrication.

There is no way they could do that without government support, government subsidies, government help, and government encouragement.

Komatsu is Japanese firm, known as a maker of construction and farm equipment. Now we have discovered that, all of a sudden it is purchasing little bits of various companies around this country, which allows them to put together technology so that they will become one of the players in the supercomputer field. Tractors today; supercomputers tommorow.

The government in Japan encourages that and I think we are going to be the losers. Take high definition television, an extraordinarily rich, powerful commercial and industrial future in this world. The Japanese get together and they coordinate. They decide what their policy is going to be then carry it out, while American industry has been more than willing to sort of let things go by, as has the Administration. Thus, Asian countries have come to dominate the economic future in many ways.

The same thing has happened in advanced ceramics and composite materials. The Japanese coordinate, decide what they are going to do, protect, put in the money for research. The government and industry work together in what is probably going to be a $200-$300 billion industry worldwide by the year 2000.

Meanwhile we sit back and, wait for Penn State or the University of Delaware or some other place to come up with technology and processes to compete.

That worries me enormously. In this morning's *Washington Post*, Bill Verity is quoted as saying that, "In the last ten months, in my view, most of the problem areas between the United States and Japan in the trade arena have been resolved."

Then he goes on to say that perhaps the main problem is that American companies are not trying hard enough. Now, I do not deny part of that last statement, but that is exactly what I keep hearing from the Japanese. I do not expect to hear it from our own Secretary of Commerce as the real problem.

You did not make that statement; he did, and I am shocked. I guess my point is that, as you indicated, four months is a long time, and a lot can take place. Your party may win the next election, in which case you will have a much longer tenure. So your views are very, very important.

I think that the world is stacked very strongly against us on the trade front, and I think we are incredibly naive as a government. I think this Administration, which really did not do anything at all about trade until very late in the game, has let the situation pass us by—opposing John Young's Competitiveness Council; all of those things that Max Baucus referred to, things we have to do in our own country to make ourselves stronger.

I cannot put any of this at your door, but I am interested if you agree with Secretary Verity and if you feel that the U.S. Government, through the Treasury and other agencies, needs to be more aggressive, in terms of looking at our future, particularly in the high technology areas.

Mr. BRADY. Well, Senator Rockefeller, I am not familiar with Secretary Verity's statement and like a lot of newspaper quotes, it may have been oversimplified. I do not think anybody could say that our trade problems with Japan are over, as they are not over anywhere else in the world. We just simply have to keep working at them.

I can only go back to what I mentioned before, which is that I think that the phrase that has been coined, free trade but fair trade, is a very important one. And if that means, should we be a little sterner or a little harder and stick up for our own country's interest, I mean our own companies' interests in world trade, I think we should. And I think that is a job that Treasury can do its fair share of and will.

The way Japan organizes its industrial side of life is different than ours. We all know what those differences are. It has its very great pluses, it also has some of its minuses; we have freedom in this country that others do not have. But I have confidence that, at the current levels of economic activity, our trade deficit will decline.

I think we have to give American industry time to adjust to a lower U.S. dollar. I have full confidence that when they have that time you are going to see a reversal in the trade deficit, a substantial reversal. So I think pointing to the problem as you do is exactly right. I have the confidence that we are going to be okay.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, Senator.

May I announce that if it is agreeable to the Committee, I would like to hold a vote at 4:30. A number of Senators who might not be

able to be here can be here at 4:30. Some of them who have left will return at 4:30. And I ask, is that agreeable to the Committee? Senator Pryor.

OPENING STATEMENT OF HON. DAVID PRYOR, A U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Mr. Chairman, that is agreeable with me. But is there a procedure that we might agree to now, where we might vote before we leave if we have to leave?

Senator MOYNIHAN. No, sir. I have to say to you a rolling quorum would not be appropriate. We have to have 11 persons present.

Senator PRYOR. Thank you, Mr. Chairman. I will be here at 4:30.

Senator MOYNIHAN. And now we have the pleasure to hear from Senator Wallop.

OPENING STATEMENT OF HON. MALCOLM WALLOP, A U.S. SENATOR FROM WYOMING

Senator WALLOP. Thank you, Mr. Chairman.

Nick, also my great pleasure to welcome you here. I admired you greatly when you were a Senator. And everything that you have done since then has given me confidence in what your tenure as Secretary would be.

I would just like to make a couple of observations before I get to a question. If one were to listen to most of the questions, one would assume that the United States was on the threshold of a permanent demised catastrophe.

I would just like to point out—Senator Bradley is not here—that the most recent Japanese and German intervention has been more to suppress the dollar, rather than to sustain it. It has been tending more to rise today than perhaps we would wish.

With regards to foreign investment in the United States, I was pleased to hear that you were not overly alarmed by that.

I would point out to the Committee, that at the close of World War II, and probably until into the 70's, that a hugely greater U.S. investment in their economies and if anything is on the horizon for us now. And they do not appear to have been shaken off their economic course by that. I think the same thing is true of Japan.

I mean, investment by itself is not a hurtful thing. And certainly, we had levels that far exceeded anything that has taken place by any country or all the combination of countries in the United States today.

With regards to the better nation status, one of the things you might want to do is to see if there is not something we can do with statistics there. Which as I understand it, counts all U.S. investment abroad at book value and all foreign investment in the United States at current value.

It makes an enormous distortion, given that a great deal of investment took place even before the Carter Administration's years of catastrophic inflation.

And also I think it is fair to point out that one of the reasons why those figures are as drastic as some portray them is because there has been a net decrease of U.S. investment abroad—bad

loans abroad or loans to Third World countries, that we are not being repaid. That figure, as I understand it, exceeds $100 billion which makes a rather significant dent in statistics.

But speaking of loans, I have just one question that I want to ask you to look into when you meet with your fellow economic ministers. And that is the issue of untied loans to the Soviet Union which are running about, as I understand it' $2 billion a month. It is not the loans to the Soviet Union that is concerning me, it is the fact that they are not tied to any performance, any project, anything in particular.

There are others that are tied. But the untied loan I think is something that from a national security standpoint, as well as an economic standpoint, bears much attention from the United States. The fact that they can divert these monies to activities of the KGB; activities within our markets, as it is to fund some total of their hard currency capability; in fact, the development of their military and the purchase of Western technology, which requires hard currency to advance their capability.

Would you be willing to raise this issue and see if perhaps there is not a common ground that the allies might take with regards to untied loans? Mind you, this is not plea not to loan money to the Soviet Union, but to make certain performance criteria a contingent.

Mr. BRADY. I certainly will, Senator Wallop.

Senator WALLOP. I thank you and I wish you well. And Kitty, all the best. Glad to see you here.

Mr. BRADY. Thank you.

Senator WALLOP. Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, Senator. Senator Pryor, I was not keeping the records. Have you had an opportunity to question yet?

Senator PRYOR. I have not.

Senator MOYNIHAN. You have not?

Senator PRYOR. No.

Senator MOYNIHAN. Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman.

I, too, want to add my commendations to our nominee today. I had the pleasure of serving with him in the Senate.

And I might add, Mr. Chairman, that just a few nights ago I was leaving the Russell Senate Office Building at night and was driving down Constitution Avenue and I looked over to my left at this very desperate man, unsuccessfully trying to hail a taxi. And I stopped to pick him up, and it was and is Nick Brady.

And the way things are going, I think he is going to have his own transportation very soon, to get around in a little better style in Washington. Nick, we welcome you.

On November the 9th—I would like to go past the election one day because I think whether a Democrat or a Republican is elected, chosen President, I have a sense that one of the first phone calls that might be made will be to Nick Brady.

And either one may call and say, okay, I have just been elected; now, what do I do? What is the next step? Because about 60 days from that date, that newly elected President is going to have to submit a budget to the United States Congress.

If you got that call on the day after the election, whether it were George Bush or Michael Dukakis, would you recommend that he cut spending, and if so, where? Would you recommend that he raise taxes, and if so, which ones? Would you say, Mike or George, we can grow our way out of these deficits and out of these huge debts? How would you respond to that question?

Mr. BRADY. Well, Senator Pryor, first of all, thanks for the ride. (Laughter)

As I remember, it was raining and you were very generous.

Senator PRYOR. Maybe you can pick me up sometime here.

Mr. BRADY. It is a deal.

I think the course that we are on right now is the right course. I see a bright future for this country, and I see growth continuing. You can imagine that I do not feel we need any new taxes. I do see the problem that we have between espousing no new taxes and the commitments that we make which are inviolate, like the Social Security system.

But I have faith that we can figure it out. And one of the things that I have been talking to some of my colleagues at the Treasury about is just the subject that you raised. Which is that, no matter who wins this election, let us see if we can come up with some things that are new and novel ways to think about our budget problem, ways to think about some other problems, such as the short-ranged nature of the way our industry invests compared to the Japanese and Germans.

So I hope that if that phone call does come, that we will have some plans and suggestions. I am not sure on the ninth of November they will be ready, but I can assure you by the time that the turn of the year comes, the Treasury will have some new ideas about a number of different subjects.

Senator PRYOR. I think we, especially on this Committee, will be anxiously looking forward to receiving those new ideas. Mr. Chairman, in the interest of time and other questioners, I will yield back the balance of my time.

Senator MOYNIHAN. There is time if the Senator wishes.

Senator PRYOR. Thank you. I appreciate it, but I thank Mr. Daschle and Mr. Heinz.

Senator MOYNIHAN. That is very thoughtful of you, Senator Pryor. Senator Daschle.

OPENING STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Thank you, Mr. Chairman. Nick, I, too, want to indicate right out that I certainly intend to support your confirmation. I have admired you for the work you have done on various Commissions, more directly, I think, for your candor about issues you faced, financial and otherwise. And so, it certainly is no sacrifice on my part to indicate support in that regard today.

I would like to address a little bit the question that was raised first by Senator Baucus and second by Senator Pryor.

Knowing you as I do, as a man of candor, I find it interesting in a campaign year or any other year, really, that as we face an issue as perplexing as that of the deficit, we find ourselves in a dilemma.

No one is willing to commit to higher revenue, but no one is willing to commit to the means necessary to bring that deficit to zero.

Now, in defense of the current policy, you have indicated that our debt is no larger today as a percent of the gross national product than it has been historically. And yet, we find ourselves watching the percent of debt service, as a part of the budget, grow to the point where it is either the second or third largest part of the budget today. That is untenable.

I am fascinated by the figure I was once given that every dollar we borrow, over 30 years time, costs to the taxpayer $13. So what do we do in a situation like this?

Obviously, the current situation is untenable. Is there a circumstance, any circumstance, when you as Secretary of the Treasury would go with your traditional characteristic candor and tell the President of the United States, "Look, we have got to raise some revenue?"

Mr. BRADY. Senator, I am not going to answer that question, if you will permit me, until I get a chance to study to a much greater degree than I have the facts that should be assembled. But, I see no reason at this moment in time why taxes have to be raised, if that is the question.

The figure that I think is as meaningful as any is one that you have stated. Which is the fact that over the last 5 years, the percentage that our deficit represents of our gross national product has declined, and it has declined substantially.

I look at our gross national product the same way I did in industry when you look at a company's sales and balance sheet. That means we have the ability to withstand this kind of debt. Its size is frightening, of course, but the whole world is bigger than it was.

Transactions take place in the billions now that used to be in the millions. And one of the things that I am always astounded by, going back and forth between government and the private sector, is how much bigger the government figures are. They are startling to everybody.

But I honestly do believe at this point in time that the figure that we should be looking at is the percentage that our debt is of our gross national product. That GNP is the vital figure in this country and I think that we can grow our way out of this. I do not think we are at a point of international or national peril.

Senator DASCHLE. Well, this is not the time or the place, I guess, to debate the issue. But I think if you talk to the average taxpayer, who saw his share of the national debt grow from about $2500 at the turn of the decade to somewhere over $8000 today, it is hard to convince him regardless of what our GNP is, that the debt and the ongoing efforts to reduce the debt are really not an important part of public debate.

Let me just ask one remaining question in the seconds I have left.

Senator MOYNIHAN. Senator, please take your time.

Senator DASCHLE. Thank you, Mr. Chairman.

It is unrelated to the debt, at least directly, but it does relate to a debate we have had going here for some time, and it is one that Senator Moynihan brought up in his initial question. It relates to the status of trust funds.

Is it your view that trust funds ought to be off budget?

We have several. We faced an issue relating to highways and airports earlier this year. We will be facing these issues again. The funds are certainly designated funds with a designated purpose. Often times they are used, as Senator Moynihan's question implied, for reasons other than that for which they were raised.

What is your view of trust funds and their position with regard to the budget?

Mr. BRADY. Well, I think that the idea that Social Security is sacrosanct is one that everybody in this room agrees with. And Senator Moynihan has been a guardian in that regard.

The way that people have looked at the budget is in terms of a unified budget. And I certainly do not have any greater wisdom than the people in this town who have been looking at it in that way.

I would be glad to take another look at the problem, Senator Daschle, and get back to you with an answer.

Senator DASCHLE. Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, Senator.

Senator, I will say, Mr. Secretary. Did I take it that it is your view that the ratio of the national debt to the gross national product has been declining in recent years?

Mr. BRADY. What I meant to say, at any rate, is that the deficit as a percentage of the gross national product has been declining. If I miss spoke, I am sorry.

Senator MOYNIHAN. The deficit has, sir.

Mr. BRADY. Yes.

Senator MOYNIHAN. But the debt has not.

Mr. BRADY. No, it has not.

Senator MOYNIHAN. Senator Heinz.

OPENING STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM PENNSYLVANIA

Senator HEINZ. Thank you, Mr. Chairman.

I join you in welcoming Nick Brady.I feel confident that as a Yale man, this nominee would be acceptable to Senator Bradley. Nick Brady, however, is also a graduate of the Harvard Business School. That accomplishment is something that Mr. Brady shares with very few others in this room.

Mr. Chairman, among Nick's many accomplishments is his service on the President's Commission that looked at the stock market crash of October 19th.

Nick, you have been commended by many people for your service as chairman on that Committee and I think quite deservedly so.

In your report you criticized the regulatory framework governing our securities markets as a principle cause of market volatility and you urged that a number of specific steps be taken. For example, you recommended a study on margin requirements.

As Secretary of the Treasury, what will you urge in following up on the Brady Commission Report?

Mr. BRADY. Senator Heinz, I think we are about on the right course. The main effort in that report was to establish the idea that we had one market between the main markets in New York

and Chicago, but also satellite markets around the United States, and that solutions to the problems which became evident in October of 1987 should be addressed with that in mind and solutions arrived at with that in mind.

I think that the solution that has been worked out between the New York and the Chicago markets, whereby circuit breakers have been put into place or will be put into place, which contemplate the existence of both markets and relate one market to the other, is a good one.

The most important things are that the settlement and clearance systems, which were tried mightily in October of 1987, be improved and also that we recognize the manner in which funds flow around the system.

The Gould Working Group on Financial Markets which took the recommendations of our Task Force, plus the SEC's and the GAO's studies and the various other studies that were made, has been meeting this summer, and I think they are going to meet again in October. They are going to meet on a continuing basis.

They are monitoring the changes. They are seeing if there are any new statistics or evidence that come up that ought to be regarded. I think we are on the right track.

Senator HEINZ. Are you saying that all the steps that need to be taken, or should be taken, have been taken?

Mr. BRADY. The answer is, in the main, yes. The main thing, Senator Heinz, as you know, was that changes be made in light of the fact that we really have had an electronic and financial revolution during the 80's and that revolution has made changes where we have one marketplace irrespective of geographical location.

The Task Force had certain things it recommended, which have not been totally adopted. But I am not sure we were 100 percent right. We did our work in 60 days. So, I am happy.

Senator HEINZ. You have certainly developed an outstanding career.Many of your accomplishments have been a succession of short term, albeit, vital important tasks. We hope that this appointment will put an end to your streak as a 60- to 90-day wonder. We would like you to get a more permanent job.

Senator MOYNIHAN. Wait. That is our line. We are the ones who are supposed to say that. (Laughter)

Senator HEINZ. I, for one, Mr. Chairman, am delighted to see that Nick Brady is not only here with Kitty and some of his family. I expect that he will be able to join our government on an official and, hopefully, far more permanent basis.

Mr. BRADY. Thank you, Senator Heinz. It is great to see you again.

Senator MOYNIHAN. Thank you, Senator Heinz. Can I follow up Senator Heinz's questions about the Brady Commission as the task force and market mechanisms is known, to say that there has been this arrangement on this circuit breaker provision. The New York and Chicago markets appear to have agreed as others have done.

But we recently learned that the National Association of Security Dealers has opposed this. I am wondering if Senator Heinz is probably aware of this also.

And I have been asked to ask of you—as Secretary of the Treasury you will be Chairman of the Inter-Agency Working Group on

Financial Markets—and would you as Chairman of that group try to achieve coordinating trading across cross markets as recommended by your Task Force—the Brady Commission?

And second, would you favor legislation proposed by the SEC to give that Agency emergency powers to halt trading for a short time during a market crisis?

I have to say to you I am not specifically aware of the recommendation of the SEC, but evidently there is one.

Mr. BRADY. Well, I certainly do support the circuit breakers across the markets that have been accepted by the two main markets. I am sorry that the NASD has not agreed that that is a good thing. I do not know the factual basis for their objection, but I will work to try and convince them.

Senator MOYNIHAN. Your position remains what it was?

Mr. BRADY. That is right.

Senator MOYNIHAN. With respect to the SEC, why do you not find what they have actually proposed.

Mr. BRADY. Yes. I have not seen precisely what their formulation is for how it should be stopped, when it should be stopped, so I would like to get back to you by looking at the details.

Senator MOYNIHAN. As you would, we would appreciate it.

Can I return, sir, to that question on Social Security which has come up several times? If I can just by preamble say, for 50 years we had a Social Security system which by design worked on a pay-as-you-go basis, with a small cushion for the occasional downturn. Such that the question of any surplus in the revenue stream never arose.

And so the financial managers in the markets and the Secretaries of the Treasury and such like that never had to think of this matter. It never existed before. Now it does. It is both in place now and in prospect for 30 years. This is a new fact of our fiscal life as a nation—of our public finances.

Now, it is hard for something that new to sink in. But could I just say, not to go through the histrionics of hearings, that I was not talking about a study or a theory, I was talking about the 1988 report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds.

They, under statute, send this to us each year. Under statute, they make a 75-year forecast. They have four sets of assumptions. The question asked is: Are we in close actuarial balance? The managing trustee is, of course, James A. Baker, The Secretary of the Treasury. And the Secretary at Labor, the Secretary of Health and Human Services then two persons from the public whom we added in 1983 legislation.

Now, the $3 trillion in surplus is a very carefully calculated year-by-year expectation of income and outgo for these trust funds. It is subject fluctuation, but not much. The record of the trustees in the half century is pretty good. And the point here is to say that, you know, $3 trillion—The New York Stock Exchange at the end of 1987 was estimated to be worth $2.3 trillion. So this is the stock exchange plus.

It is certainly fair to say that we all agree that we must not use Social Security for other things. But, in fact, the ordinary day-to-day mechanisms of the Treasury taking the cash that comes in

through the payroll tax, issuing bonds to the trust funds, and holding the cash for itself, that will automatically go to other costs of government.

The trust funds have the bonds and they will be paid in due time. But for the moment, it will be just an effortless, almost silent process where by these surpluses disappear into operating expenses and are lost forever to the true savings investment.

Would you agree with me on that? That, for instance, this year we are using the surplus for current operating expenses.

Mr. BRADY. Senator, you have raised in your hand there a very thick report. I have not had the chance to look at it. What I would like to do is look at it and reply back to you at a future date.

Senator MOYNIHAN. Oh, look, do not even think of it in terms of, you know, something you have to answer and there is a question and this is the answer. But, you know, this is our annual report. There are 52 of them, I think, somewhere in archives of the Social Security Administration, and you signed it. You are the managing trustee.

And I want to say to you that this year, and last year, and next year, we are going to take large surpluses—They are not quite as large as they will be. But this year the surplus is $32 billion; next year it will be $34 billion; 1990—$41 billion; 1991—$48 billion. So they get up to be much larger.

That money has disappeared into ongoing Government costs. Where as if it were used to retire privately-held debt, it would result in an increase in savings. And if we do not have that increase in savings when the baby boom does retire, we are not going to have an economy that can maintain the levels of benefits that we have provided.

It is really not more complicated than that. I make the simple point that 17 years ago our birthrate fell below reproduction level. And that has meant that we have had to provide a trousseau of things because of the demographic profile to come. So perhaps you might want to come up when you have a moment and talk to our Subcommittee about this.

Mr. BRADY. Absolutely.

Senator MOYNIHAN. I see where a few Senators are back. Senator Baucus.

Senator BAUCUS. Thank you, Chairman.

Mr. Brady, as I listened to your conversation with, I think, Senator Daschle, I think you said that when you are looking at our Federal budget deficits, the important figure to look at is our budget deficit as a percent of the gross national product. As you pointed out, that figure is over, I guess, the last year or two is declining slightly.

Is that to say that we should not worry about our Federal budget deficit? That is, our Federal budget deficit is okay because its percent of the GNP is declining?

Mr. BRADY. No, it is not to say that, Senator Baucus. And if I gave that impression, I certainly want to correct it.

I think the internal deficit that we have in this country is something that has to be worked down. I am comforted by the fact that Members of Congress and the Executive Branch have reduced the

size of the deficit from $220 billion two years ago to $150 billion now. That is not a great step, but it is the right direction.

I gather that althougn estimates vary for next year, that we are even looking at a further decrease there. So, Senator, I cannot look at the deficit and say it is something we ought to countenance, it is something we should not countenance.

The efforts that you and your colleagues have made to maintain, to control the spending, and to try to arrive at conditions in this country to provide the growth to make that deficit go down are on the right track as far as I am concerned.

I certainly did not mean to give you the impression that I thought that the size of the deficit is all right.

I think what is all right is the effort to try and bring it down.

Senator BAUCUS. This is not the first time you have thought about this matter. How do we, in your judgment, go about doing this then? I mean, in all its niceness to say, you know, we are making efforts and issue platitude and statements like that, but the fact of the matter is that the American people, I think, are concerned about how we go about doing it to a significant degree so that we are not worrying about this quite as much as we now are as a country and as a people.

Could you be more specific, more precise, rather than just say, you know, we work at it?

Mr. BRADY. No, and I do not want to flip. But I think we are doing it. I mean, I think the fact that the deficit is coming down is proof that we are on the right course, and that is a joint effort of both the Administration and the Congress.

Senator MOYNIHAN. Would Senator Baucus just field for comment?

If I could just say, Nick, this is the centrality of the Social Security surpluses. The deficit has broken that $200 billion barrier. It got up to $221 billion in '86. It is now coming down. It looks to be coming down quite a bit. It is only coming down, only appearing to, because of the Social Security surpluses. If you took those surpluses out, it would still be very close to $200 billion.

Senator BAUCUS. That is an excellent point.

Senator MOYNIHAN. It would be back to about $200+ frankly in the next couple of years.

Senator BAUCUS. Yes. Because of what are plus going deficit.

Senator MOYNIHAN. Interest payments now exceed the actual deficit. I am sorry, sir.

Senator BAUCUS. Thank you, Mr. Chairman, for making that point.

I do not think that, frankly, we are making a lot of progress. I think the point the Chairman made is a very good one.

Mr. BRADY. Well, Senator, I can only tell you that I wish the progress were faster. But I think the efforts are in the right direction.

I served in the Senate. I know how hard it is to vote nay on bills that spend money but that has to be done. I think that if we keep batting away at it, we will get there.

Senator BAUCUS. If the Senate passes this Technical Corrections Bill as it now stands would you, as Treasury Secretary recommend that the President sign it?

Mr. BRADY. I do not know all the details, Senator Baucus, of the Technical Corrections Bill. I do know that there are some parts of that Technical Corrections Bill which I think the Administration supports and I do support.

For instance, the part of the Bill that would benefit farmers charged tax on their purchases of diesel fuel.

Senator BAUCUS. Because they do not have to pay the tax?

Mr. BRADY. That is right.

Senator BAUCUS. For farmers and off-road vehicle users?

Mr. BRADY. That is correct. I think that 1987 Act provision ought to be changed and I think the Administration agrees with that. I do not know every detail of that Bill. I think it is changing almost every day.

To me, it looks like a pretty sound bill and I give great credit to you and your colleagues for trying to contain the expenditures at the level that you have contained them. That has been a great job.

Senator BAUCUS. I appreciate that. But it stands now, you do not see any reason at least for recommending a veto of the bill?

Mr. BRADY. Sorry?

Senator BAUCUS. As it stands now, is it correct to say you do not believe that you will recommend the President to veto it?

Mr. BRADY. I have learned just enough in the three weeks I have been preparing this not to say yes to that kind of a question before I have actually seen the bill, Senator. So if you would let me take a look at it, I will answer it when I take a look at it.

Senator BAUCUS. Thank you.

Senator MOYNIHAN. If I could just take the liberty of my colleague for minute. We are going to have a hearing. This is all going to be printed up and get it bound in Morocco for Christmas. So we might as well have some numbers in here.

Here is the August economic and budget outlook update. This is the Congressional Budget Office. Here are the base line projections for the deficit without Social Security. And they are: 1988—$194 billion; 1989—$199 billion; 1990—$199 billion; 1991—back to $206 billion; 1992—$212 billion; 1993—$220 billion; 1994—Senator Baucus would be interested in this. By 1994 the CBO projects a $234 billion deficit. Only to be disguised by $113 billion surplus in Social Security, so it shows up as $121 billion. But, in fact, you have just wasted an opportunity to invest $121 billion in, you know, plants and equipment, or what you will.

I would like to put that in the record at this point. And also the actuary's estimate of the 30-year growth in funds.

[The information appears in the Appendix.]

Senator Pryor.

Senator PRYOR. Yes. Thank you, Mr. Chairman.

While we are waiting for our vote, I thought that I would take just a moment and not ask a question, but to inform.

It may have escaped your attention, Nick, you had made mention earlier in a statement about the General Accounting Office, the GAO. Yesterday, the GAO made available to the Congress a report on the Federal Home Loan Bank Board and the creation of several subsidiaries of the Federal Home Loan Bank Board that oversees our troubled S&L industry.

And the fact was that the FADA creation—I believe that is the Federal Assets Distribution Authority, or Agency, or whatever. According to the General Accounting Office, FADA has been illegally constituted. It is an illegal entity.

Now, with FADA going out and disposing of hundreds of millions, or billions of dollars of assets, buying and selling and whatever, the next question is—and I think this is for much smarter people than myself—are all of these dispositions ultimately going to be tainted as illegal because of those decisions made by an illegal entity of the Federal Home Loan Bank Board?

I do not know that answer, but I am saying that this whole S&L situation out there may be a lot deeper and a lot more complex than any of us had ever imagined as a result of the GAO delving into this, and found that these creatures of the Federal Home Loan Bank Board were, in fact, illegally constituted.

I just wanted to bring that to your attention. I shared that with Senator Proxmire today. I did not think that he had seen it also, as the Chairman of the Banking Committee.

What the next step is, I do not know. But I think it could be of serious impact.

Senator MOYNIHAN. Well, there is a softy. Go right ahead.

Mr. BRADY. I beg your pardon?

Senator MOYNIHAN. I mean, answer.

Mr. BRADY. Well, I do not have an answer. I have not seen the report. I agree, if it is illegal that is not a good thing. (Laughter)

Senator MOYNIHAN. May I first state that Senators Danforth and Symms will have some questions they would like to submit for the record. We want to see that you are at the meeting of the G-7, and so, we will not await your written responses. But we will take in good faith the fact that we will get them from you. I just want to record them.

Mr. BRADY. You will.

[The questions appear in the Appendix.]

Senator MOYNIHAN. On the subject of not illegality, but something pretty close, I think that the reason that nobody thought of illegal is that nobody ever sought to abscond with $28 billion.

But in 1984 and again in 1985, the Secretary of the Treasury diverted vast sums of Social Security revenues to the General Operating Funds. In a situation where the debt ceiling had been reached. And the Secretary was in the position of either having the United States default on its credit or to use these resources at hand in a way which was not, frankly, in my view, not legal.

This was an intolerable situation in which your predecessor was placed. He could not do the right thing either way, in that regard.

Just so the record will have it, in September or October of 1984, roughly, $19.5 billion was credited to the trust fund but not invested in Treasury securities. That is to say, the debt ceiling had been reached and the Treasury could not issue any further securities. So, it just held the cash and used it for other purposes.

But then it went beyond that, sir, it cashed in $10 billion in order to pay bills. These were bonds with maturity dates between 1988 and 1990.

Then again in September to November of 1985, the Treasury failed to invest $28 billion and, in fact, cashed in, redeemed, $27.9 billion. A vast sum—$50 billion in one year.

Two things. The first thing is to say that the binding failure in all this is that the Congress was not told. Had this Committee and the Ways and Means Committee on the House side—had the Secretary or his designate comes before us and said, now let me explain to what situation we are in, and what we are going to do, unless you tell us we absolutely cannot. And if you tell us that, let us tell you what will then happen.

That we were never told. We learned from the actuary, when Social Security reports what its portfolio is. Witnesses came to us who were not candid. At no moment was it Secretary Baker's intention that a witness should appear that was not candid, but that happened I am sorry to say.

We have on the first day of the Congress, I introduced legislation S.33 that would just make it a law about the Secretary could not cash Social Security trust fund bonds saved to pay Social Security benefits. That law would mean that you would not have the option to make this other use of the monies.

And so everybody would be on notice that if we ever get back to that absurd situation of holding the government captive to a debt ceiling that is rapidly being approached that you would not have any option. So the Congress would say, do not suppose that you were not told. You knew what I would do.

Could I ask if you would find yourself generally supportive of that position?

Mr. BRADY. Senator Moynihan, I think it would be extremely helpful if that type of a law was passed and set out the guidelines for the Secretary of the Treasury's operations under that circumstance. I think it is a first- rate idea.

Senator MOYNIHAN. I thank you. Could you talk to some people on the Ways and Means in the same spirit.

Mr. BRADY. I certainly will.

Senator MOYNIHAN. It is simply a matter of not putting the Secretary, who has two roles. He is Secretary of the Treasury and he is Managing Trustee of these trust funds. He found an intolerable conflict. He could not perform. If he performed one role correctly, he performed the other one incorrectly. And marginally, possibly illegally.

May I say, all complete restitution has been made. All the monies and lost interest are back. It was not a good thing for us not to be told and the public trustees were not told. So it was just, you know, one of those episodes and you are trying to get the confidence in the system back. You would not allow that at Dillon Read and you will not stand for it in the trust funds either.

Mr. BRADY. I think it would be a real help.

Senator MOYNIHAN. All right, sir. Now it comes only rarely to a witness before this Committee for a position of such stature.

Would you like to sum up; is there anything you would like to say before you are sentenced to the servitude of the Secretary of the Treasury for an indefinite period, possibly with no furloughs?

Mr. BRADY. Senator, only to say that it is a great honor to be nominated to be Secretary of the Treasury. I am also very grateful

for the interest of your colleagues here on the Senate Finance Committee, and particularly yourself.

I thank you for your interest.

Senator MOYNIHAN. We thank you, sir, for your very open, and candid, and careful responses. We did not want you to make up solutions on the wing. We have told you some of our concerns.

I think you have heard them and an abiding concern with the trade deficit and a conviction that we have not addressed the issue of our own internal budgetary deficit. It is just not there in the numbers. We live with them every day.

Third, a concern that we will resolve, we will get around, we will avoid facing the actual ongoing operating budget deficit by spending the surpluses of the Social Security fund which otherwise could be translated into an increase in national savings. You could probably quadruple the rate of national savings if you retired the privately- held debt and transferred it into the trust funds.

Those three I think are—plus Senator Bradley's concern about the Third World Debt situation that he has mentioned. A transfer of $40 billion in the last year from Latin America to the Developed World is hardly a pattern in which we expected in the post-World.

With that, sir, if you have nothing further to say, I am going to ask that the Committee stand in recess until the hour of 4:30.

I would like to ask our distinguished witness, former Senator Brady, the nominee, if he would keep himself available. If other Senators appear in this 15 minutes, I will call the Committee back into session for purposes of addressing questions.

The Committee will stand in recess until the hour of 4:30 p.m. at which time there will be a vote. I would ask all staff members to inform their Senators that this is the case and we must have 11 members process or else Mr. Brady will be representing us at the G-7 meeting next week.

[Whereupon, at 4:15 p.m., the hearing was recessed until 4:30 p.m.]

APPENDIX

ALPHABETICAL LIST AND MATERIAL SUBMITTED

STATEMENT OF SECRETARY DESIGNATE NICHOLAS F. BRADY

BEFORE THE SENATE FINANCE COMMITTEE

TUESDAY, SEPTEMBER 13, 1988

Mr. Chairman and distinguished Members of the Committee, it is an honor for me to appear before you today as the President's nominee to become the Secretary of the Treasury.

I come before you today as a nominee for my second government position in less than six years. My tenure as a Member of the Senate, although short in duration, was long in quality and learning. Perhaps the single, most important lesson of those eight months was that members of the government -- from both the Executive and the Legislative Branches -- work most effectively in the national interest when they work together in a bipartisan way. If confirmed, that lesson will be a guiding principle.

I have had the distinct pleasure of working with many of you when I was in the Senate, others when I served on various Presidential Commissions and, most recently, when I chaired the Presidential Task Force on Market Mechanisms. In each case, I found that understanding and solid results were obtainable when all views and ideologies were observed and taken into account. This, too, will be a guiding principle.

The founder of the firm for which I have worked for over 30 years maintained that when faced with a problem one should assume that "the devil lies in the details," that there was no substitute for doing the pick and shovel work. I also believe firmly in that guiding principle.

Although there are few months left in President Reagan's Administration, there are important matters before us which demand our attention:

We have a strong, viable economy now enjoying its 70th month of expansion. As our exports rise and our trade deficit declines, we must continue a sound monetary policy and a responsible fiscal policy to keep the economy moving in the proper direction.

Largely through the efforts of my predecessor, Jim Baker, we have developed strong and meaningful relationships with the G-7 countries under which we have been able to coordinate international economic policies not only to our mutual benefit but to the benefit of the rest of the world. In this regard, my first task, if confirmed, will be to attend a G-7 meeting in Berlin late next week and to represent the United States at the Joint Annual Meetings of the IMF/World Bank. I will assure both gatherings of our government's intention to continue the strategy of economic cooperation.

We have a Bipartisan Budget Agreement, worked out nine months ago between leaders of the Congress and the Executive Branch, which will ensure appropriate deficit reduction without dislocation during this fiscal year and next. Adherence to this agreement is vitally important to economic stability, and I will do everything in my power to guarantee its integrity.

To be sure, there are problems at home such as those facing the thrift and banking industries and abroad such as treatment of Third World Debt. All require surveillance and attention. None is insurmountable.

I would be pleased to answer any questions the Committee may have. If confirmed, I look forward to working with Members of the Finance Committee, the Senate and the Congress as a whole to address and resolve the matters before us. Thank you.

Written Question from Senator Daschle and Response of Mr. Brady

QUESTION:

Is it your view that trust funds ought to be off budget? What is your view of trust funds and their position with regard to the budget?

RESPONSE:

The Federal budget is divided into trust funds and Federal funds. Trust funds collect certain taxes and other receipts for specified purposes established by Congress; Federal funds are used for general purposes of the Government. Not all trust funds are part of the Federal budget, however, so the standard measure of Federal budget balance published by the Government does not reflect all Government receipts and outlays. Total receipts and outlays of the Federal Government are comprised of both on-budget and off-budget funds, so most analysts disregard the on-budget totals by themselves as misleading.

To assess the overall impact of the Federal budget on financial markets and the economy, it is important to have comprehensive estimates of Federal budget receipts and outlays from all sources. Trust fund receipts and outlays must be part of this comprehensive accounting. For example, if Social Security spending were not included in the budget totals, analysts would have difficulty in determining overall levels of government spending for such purposes as preparing forecasts of GNP and Federal borrowing requirements. In apparent recognition of these points, the Gramm-Rudman-Hollings Act (GRH) of 1985 requires that the target for budget balance incorporate total receipts and outlays, that is, both on-budget and off-budget funds.

The 1983 Social Security Amendments called for removal of the Old-Age and Survivors Insurance (OASI), Disability Insurance (DI), and Hospital Insurance trust funds from the budget by 1993. This action was intended to insulate the Social Security program from pressures caused by unrelated budgetary considerations. For this purpose, the off-budget treatment of the trust funds is acceptable. GRH accelerated removal of the OASDI trust funds from 1993 to 1986. Currently, the OASDI trust funds are the only Federal accounts off-budget.

The relationship between the OASDI trust funds and the Federal budget arises from the investment policy of the trust funds. When OASDI tax receipts exceed benefit payments, the surplus is invested in special issue U.S. Government bonds. This procedure provides trust funds monies with maximum safety and allows them to earn interest. This process also reduces the Government's financing needs in the credit markets. Of course, the opposite occurs if trust fund outlays exceed cash receipts. In that case, Government borrowing requirements rise causing increased pressure in the credit markets. This relationship between the trust funds and the Federal budget exemplifies the need to focus on the total budget balance as described above. Other trust fund surpluses are invested in a comparable fashion.

Placing additional trust funds off-budget could disguise actual spending levels from the public. This could provide an incentive for the Congress to order increased spending from any surpluses available in them.

Question For The Record
In Connection With Secretary Brady's Confirmation Hearing,
Submitted By Senator Danforth

Question: Mr. Brady, in carrying out the Administration's tax policy priorities for the remainder of this term, I understand you share the President's opposition to raising taxes. As such, is it fair for us to assume that Secretary Chapoton's testimony before this Committee on July 13, 1988, opposing any further steps towards repeal of the completed contract method of accounting, still represents the Administration's position on this matter?

Followup: Do you support the Administration's position opposing Section 312 of the House technical corrections bill which imposes $2.4 billion in new taxes primarily on the aerospace and construction industries simply to pay for unrelated revenue losing provisions?

Answer: I am very concerned about the two most onerous nontechnical revenue raisers in the House technical corrections bill: repeal of the completed contract method of accounting, contained in section 312 of the bill, and lowering of the dividends received deduction for corporations from 70 percent to 50 percent. The position on the completed contract method of accounting articulated by Secretary Chapoton in his July 13, 1988, testimony remains the Administration's position on that issue. Of course, the Administration's overall position on a final technical corrections bill will be based on the overall content of that bill.

QUESTION FOR MR. NICHOLAS BRADY FROM SENATOR SYMMS

RE: Increasing volume of untied lending by Japan and Western Europe to Soviet bloc governments

In recent years the Soviet Union and soviet bloc governments have increasingly borrowed "untied" funds from Western banks. Earlier this year a major securities underwriting was offered in Germany, and just last week three of the four major Japanese securities underwriters entered into a deal with the Soviets.

Former Treasury Secretary William Simon has published an article in the current issue of the Reader's Digest sounding an alarm about this practice. There was also an article in the June 30 issue of the London Economist, discussing the potention for Eastern Europe to become the next decade's "debt bomb" -- like Latin America became in the 1970s.

Secretary of Defense Carlucci has identified this problem as one of "burden sharing": the financing of the Soviet bloc by our allies increases the overall cost of America's defense effort.

Question: As Secretary of the Treasury, what would you do to encourage our allies -- Japan and Western Europe -- to exercise prudence in this area?

Do you see it as a growing problem? If not, why not?

Question for the Record
In Connection with Secretary Brady's Confirmation Hearing,
Submitted by Senator Symms

I am mindful of the need of a prudent approach to diversified economic relations with the Soviet Bloc consistent with our political and security interests. I appreciate the importance of close coordination with our allies on such matters.

When the issue of Western lending to the Soviet Bloc was discussed at the Toronto Economic Summit last June, the Summit countries adopted a policy that East-West economic relations, including financial relations, can be expanded "so long as the commercial basis is sound, they are conducted within the framework of the basic principles and rules of the international trade and payments system, and are consistent with the security interests of each of our countries."

I believe it is important to continue monitoring and reviewing large-scale loans to the Soviet Bloc, particularly loans of an untied, general purpose nature. At upcoming international meetings, I certainly plan to make these views known. Of course, the views of Congress will continue to be taken into account in assessing our financial relations, and those of our allies, with the Soviet Bloc countries.

COMMUNICATIONS

United States
Office of Government Ethics
P.O. Box 14108
Washington, D.C. 20044

SEP 7 1988

Honorable Lloyd Bentson
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with the Ethics in Government Act of 1978, I enclose a copy of the financial disclosure report filed by Nicholas F. Brady, who has been nominated by President Reagan for the position of Secretary of the Treasury.

We have reviewed the report and have also obtained advice from the Department of the Treasury concerning any possible conflict in light of its functions and the nominee's proposed duties. Prior to assuming this position with the Department, Mr. Brady will terminate his employment with Dillon, Read & Company, and sever all financial arrangements except his pension interest as soon as practicable as outlined in his enclosed letter to our Office, dated September 1, 1988. He has also agreed, as is appropriate in light of these contemplated actions, to recuse himself from any particular matter in which Dillon, Read & Company or Travelers Corporation, its parent company, is a formal party or in which either company has a direct financial interest.

Mr. Brady has also recused himself from participation in matters involving NL Industries, Purolator, and NCR Corporation because of his interests in certain retirement plans in these companies. He also intends to resign from all positions listed on his Financial Disclosure Report (SF 278) as well as entering into a written agreement to suspend his co-executor/trustee duties and obligations throughout his government service.

In addition, Mr. Brady intends to establish two blind trusts under the Ethics in Government Act of 1978. The first will contain both a qualified diversified portfolio, the assets of which will not be deemed financial interests for the purposes of the conflict of interest statutes and regulations, and a portfolio of nonmarketable securities that will continue to be financial interests of Mr. Brady's until sold or reduced to value of $1,000 (one thousand dollars). The second trust will be a qualified diversified trust in which he will place the proceeds of his profit sharing plan with Dillon, Read & Company. Until

these trusts are in place, Mr. Brady will recuse himself from any particular matter affecting an asset which he intends to place in these trusts as necessary to avoid a real or apparent conflict of interest. A management trust will be established to relieve Mr. Brady of the operating responsiblities of assets not suitable for inclusion in either trust.

Subject to the fulfillment of these commitments, we believe that Mr. Brady will be in compliance with applicable laws and regulations governing conflicts of interest.

Sincerely,

Frank Q. Nebeker
Director